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The Director of Central Intelligence

Washington, D.C. 20505

Senior Review Panel

NIC-03595-87
8 September 1987

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

SUBJECT: Senior Review Panel Comments on Draft
Concept Paper and Terms of Reference (TOR)
for IIM: Dollar Costing of Foreign Defense
Activities; A Primer on Methodology and Use
of the Data, internally dated 25 August 1987

1. The Panel considers this a laudable, methodologically important initiative. We think the papers set out a useful analytic framework, well-elaborated and appropriately addressed to the purposes of the IIM, the first on the subject.

2. We look forward with interest to the draft paper.



William Leonhart



James D. Theberge

cc: Chairman, NIC
VC/NIC (Mr. Fuller)
VC/NIC (Mr. Hutchinson)
NIO for Economics

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Signers

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SUBJECT: Senior Review Panel Comments on Draft Concept Paper
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of Foreign Defense Activities: A Primer on Methodology
and Use of the Data, internally dated 25 August 1987

ODCI/SRP [redacted]

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Distribution:

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- 1 - Chairman, NIC
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NATIONAL INTELLIGENCE OFFICER
FOR ECONOMICS

National Intelligence Council

25 August 1987

MEMORANDUM FOR: Senior Review Panel

FROM: Deane E. Hoffmann
NIO/Economics

SUBJECT: IIM: Dollar Costing of Foreign
Defense Activities: A Primer on
Methodology and Use of the Data

Attached for your review is Concept Paper/Terms
of Reference for subject IIM. I would appreciate
comments at your earliest convenience.

Deane E. Hoffmann

Deane E. Hoffmann

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Attachment:
As stated

C/NIC

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IIM: Dollar Costing of Foreign Defense Activities:
A Primer on Methodology and Use of the Data

Concept Paper

This IIM is being prepared in response to a request by Lieutenant General Perroots, Director, DIA, to review the Intelligence Community's methodology for the dollar costing of Warsaw Pact and NATO defense activities. No previous IIMs have been prepared on this subject. The purposes of the IIM are:

- To explain what estimates of the dollar costs of foreign defense activities mean, laying out guidelines and caveats for their proper use.
- To document the concepts, definitions, and methodologies used.
- To assess the confidence levels associated with the estimates from this methodology.
- To provide, a succinct, one-page guide to the uses and abuses of dollar costing to be contained in intelligence papers using this methodology.

US policymakers have come to rely on dollar cost comparisons of Soviet-US defense activities in their planning and budgeting processes. Dollar cost comparisons have been extended to Warsaw Pact and NATO defense activities. The IIM will provide policymakers with a better understanding of the derivation and interpretation of these estimates. Also, an assessment of information gaps and weaknesses in the methodology will aid the Intelligence Community in assessing how collection and analytic resources can be focused to further improve the estimates.

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The IIM will provide an overview of the dollar costing method; it will not put forth results of the methodology except as needed to illustrate the approach or assess uncertainties. It will be drafted jointly by CIA and DIA, reviewed initially by the joint Military Costing Review Board, and then coordinated throughout the Intelligence Community.

Key Questions

1. What are we trying to measure?
2. How are estimates of dollar costs of foreign defense activities formulated?
3. How should dollar costs of foreign defense activities be used and interpreted?
4. What are the strengths and weaknesses of our estimating methodologies?

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IIM: Dollar Costing of Foreign Defense Activities:
A Primer on Methodology and Use of the Data

Terms of Reference

- I. Why are dollar valuations of the defense programs and activities of foreign countries necessary?
 - A. Why are dollar cost valuations needed for aggregate, international comparisons?
 - B. What do dollar cost measurements of defense activities include?
 - C. What is the history of dollar costing in the Intelligence Community?
- II. What caveats should govern the use of dollar cost estimates?
 - A. How are dollar costs properly used?
 - B. When are dollar valuations inappropriate?
- III. What are the key methodological decisions made to develop the methodological framework?
 - A. What considerations regarding the production base, level of technology, and efficiencies are addressed in adopting a costing methodology?
 - B. Why are costs expressed in constant dollars?
 - C. What assumptions are made about productivity gains for specific products?
 - D. What alternative concepts exist for assigning dollar costs to foreign defense activities?
 - E. What conceptual differences on these issues exist within the Intelligence Community?

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- IV. Given this methodological framework, how are the costs calculated?
- A. Given specific circumstances and constraints on data, what are the different costing methodologies and when are they used?
 - B. What problems arise in practice?
 - C. How is each methodology applied in Intelligence Community estimates?
- V. What confidence do we have in our estimates?
- A. What sources of data exist?
 - B. Where are the gaps in the data?
 - C. How does our confidence in aggregate measures compare with our confidence in estimates of individual components?
 - D. What is our overall level of confidence?

Appendices

- A. What is the "index number" problem inherent in artificially costing a country's goods and services in another country's currency?
- B. What are the quantitative effects of CIA/DIA disagreement on weapons costs?
- C. How do we measure the dollar value of Research, Development, Testing and Evaluation efforts?
- D. How do we estimate non-Soviet Warsaw Pact defense costs?
- E. How do we estimate non-US NATO defense costs?
- F. How are US outlays by resource category and mission calculated?

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